SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1934

No. 611

THE IVANHOE BUILDING AND LOAN ASSOCIATION OF NEWARK, N. J., PETITIONER,

vs.

THOMAS A. ORR, TRUSTEE OF EASTERN SASH & DOOR COMPANY, BANKRUPT

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

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[fols. A & 1]

IN UNITED STATES DISTRICT COURT FOR THE DISTRICT OF NEW JERSEY

In Bankruptcy, No. 17,602

In the Matter of Eastern Sash & Door Company, a Corporation of New Jersey, Bankrupt

Docket Entries

Apr. 23, 1932. Petition filed.
Apr. 23, 1932. Adjudication.
Apr. 23, 1932. Order of reference to George W. W. Porter, Newark, Referee.
June 24, 1932. Order appointing Thomas A. Orr, Trustee.
Sept. 28, 1932. Claim of The Ivanhoe Building & Loan Association of Newark, N. J.
July 12, 1933. Petition of Trustee and Order to Show Cause why said claim should not be re-examined.
Nov. 21, 1933. Order of Referee Porter reducing said claim.
Nov. 28, 1933. Exceptions to said Order filed.
Nov. 28, 1933. Petition for Review of said Order.
Dec. 18, 1933. Referee's Certificate of Review.
Dec. 21, 1933. Notice of Hearing on said Petition.
Jan. 15, 1934. Order of U. S. District Court Affirming Referee's said Order.
Feb. 23, 1934. Copy of Order of U. S. Circuit Court of Appeals Allowing Appeal.

[fol. 2] In United States Circuit Court of Appeals, For the Third Circuit

In Bankruptcy, No. 17,602

On Petition for Review of Order of U. S. District Court

In the Matter of Eastern Sash & Door Company, a Corporation of New Jersey, Bankrupt

Stipulation of Facts

It is hereby stipulated and agreed by and between Abraham Alboum, Esquire, attorney for petitioner, and Charles

E. Hendrickson, Esquire, attorney for the Trustee, that following are the facts at issue.

1. On July 21, 1927, Abraham Portnoff, et als.. executed and delivered their bond in the penal sum of $23,000 to The Ivanhoe Building & Loan Association of Newark, N. J., the petitioner herein; and at the same time the said obligors, being then the owners of property known and designated as No. 386 Leslie Street, Newark, N. J., to secure payment of said bond, executed and delivered to the petitioner herein a mortgage on said property, in the sum of $11,500.

2. On October 7, 1927, the said mortgagors sold and conveyed the said property to the bankrupt, which conveyance contained the following clause: "This property is conveyed [fol. 3] subject to a mortgage in the nominal sum of $11,500 held by the Ivanhoe B. & L. Association, which mortgage the grantee hereby assumes and agrees to pay."

3. On October 11, 1927, the bankrupt sold and conveyed the above-mentioned property to one Clara Yavne, which conveyance contained the following clause: "This conveyance is made subject to a mortgage held by the Ivanhoe B. & L. Association in the sum of $11,500 which the grantee hereby assumes and agrees to pay."

4. On April 2, 1932, the petitioner herein filed its bill of complaint in the New Jersey Chancery Court to foreclose said mortgage. Final decree was entered therein on June 30, 1932. Sheriff's sale was held on August 9, 1932, and the aforesaid mortgaged property was sold to complainant (petitioner herein) for $100, leaving a deficiency on said bond in the sum of $10,739.94.

5. On April 23, 1932, Eastern Sash & Door Company was adjudicated a bankrupt.

6. On September 28, 1932, and within six months from the date of said sheriff's sale, the petitioner herein filed its proof of debt, as a general unsecured claim, in the sum of $10,739.94, being the amount of said deficiency, as follows:

Decree in Foreclosure suit	$10,220.96
Interest on same	88.58
Taxed costs	386.07
Interest on same	1.99
Sheriff's Fees	65.88
	$10,763.48
[fol. 4] Less purchase price at Sheriff's Sale	100.00
	$10,663.48
Plus interest	76.46
Amount of deficiency	$10,739.94

7. On July 12, 1933, the Trustee herein filed a petition for re-examination of said claim, and thereupon the Referee in Bankruptcy made an order directing the petitioner to show cause why the said claim should not be re-examined, rejected and expunged; and the matter having been duly argued and heard, the said Referee did, on November 21, 1933, make and file an order that the said claim be reduced to $1739.94 and allowed at said amount upon the list of claims, as a general unsecured claim.

8. The Referee found as a fact and it is hereby stipulated and agreed, that the actual and true value of said property at the time of said sheriff's sale was $9000.

9. Thereupon petitioner filed exceptions to the Referee's said order and on November 28, 1933, the petitioner filed a petition for review of the Referee's said order. Thereafter said Referee filed a certificate of review, as provided by law.

10. Said petition for review came on to be heard before Honorable Guy L. Fake, Judge of the United States District Court, who, upon consideration thereof, did, on January 15, 1934, make an order confirming the Referee's said order. Petitioner duly excepted to said order, which exception was allowed and sealed accordingly.

[fol. 5] It is further stipulated and agreed that the following papers in this matter, and no others, shall be printed in and shall constitute the transcript of record on this appeal, viz:

1. This stipulation of facts.
2. Order of Referee Porter, dated November 21, 1933.

3. Ruling of Judge Fake, dated January 15, 1934.
4. Order of Judge Fake, dated January 15, 1934.

Dated: February 10, 1934.

Abraham Alboum, Attorney for Petitioner. Charles E. Hendrickson, Attorney for Trustee.

[fol. 6] In United States District Court, for the District of New Jersey

In Bankruptcy

In the Matter of Eastern Sash & Door Co., Bankrupt

Order Reducing Claim—Filed November 21, 1933

The Trustee of the estate of the above-named bankrupt having filed in the office of the Referee a duly verified petition praying that the proof of debt heretofore filed herein by Ivanhoe Building & Loan Association of Newark, New Jersey, an alleged creditor for $10,739.74, be re-examined, rejected, expunged or reduced, and an order having been made herein, that hearing be had thereon on the eighth day of August, 1933, and due notice of said hearing having been given to said claimant and to the said trustee, and the said claimant having appeared by counsel on said day and testimony having been taken thereon, now on reading and filing the Trustee's said petition and upon all the proceedings had herein and upon the evidence submitted to the Court and after hearing counsel and considering the memorandum filed by counsel,

It is on this twenty-first day of November, 1933, on motion of Charles E. Hendrickson, attorney for the Trustee, [fol. 7] Ordered that the prayer of said petition be and the same is hereby granted;

And it is further ordered, That the said claim of Ivanhoe Building & Loan Association of Newark, New Jersey, be and it hereby is reduced to $1739.94 and allowed at said amount upon the list of claims herein as a general unsecured claim.

G. W. W. Porter, Referee in Bankruptcy.

[fol. 8] IN UNITED STATES DISTRICT COURT

Before Hon. Guy L. Fake, U. S. D. J.

Lefcourt Building, Newark, N. J.,
Monday, January 15, 1934.

Appearances:

Abraham Alboum, Esq., for Ivanhoe Building & Loan Association of Newark, N. J.; Sidney L. Jacobs, Esq., appearing for Charles E. Hendrickson, attorney for Trustee.

OPINION

The Court (orally, at close of argument): As I understand the record, it discloses this, that the bankrupt purchased certain real estate from Portnoff & Adelstein who, prior to the sale to the bankrupt, had mortgaged the premises to the Ivanhoe Building & Loan Association, and the bankrupt assumed and agreed to pay the bond and mortgage as part of the purchase price for the said property. Thereafter, the bankrupt conveyed the property by deed to one Yavne, who assumed and agreed to pay the said bond and mortgage as part of the consideration price for the premises.

About five years after the bankrupt sold the property to Yavne, the bankruptcy proceeding with which we are now concerned was commenced by an involuntary petition. The claimant here is the Ivanhoe Building & Loan Association, and in its behalf it is asserted that it is entitled to prove its claim in the bankruptcy proceedings for the full [fol. 9] amount of its final decree with interest and costs less the sum of one hundred dollars bid at the sheriff's sale. It is urged on behalf of the trustee that the Ivanhoe Building & Loan Association must credit on account of its claim the value of the real estate which it took under the foreclosure, and which value is conceded by both sides to this controversy as the sum of $9000. Counsel for the Loan Association bases his contention upon Section 1, subsection (23) of the Bankruptcy Act, which reads as follows:

"Secured creditor shall include a creditor who has security for his debt upon the property of the bankrupt • • • "

And he contends that the property not being owned by the bankrupt at the time of the filing of the petition in bankruptcy, the value thereof cannot be considered in reduction of the mortgagee's claim. In other words, that the bankrupt having disposed of the property prior to bankruptcy, leaves the trustee here in a position where the value of the property cannot be used in reduction of the Loan Association's claim.

On reading subsection (23), nothing is found which would indicate that the definition limits the "secured creditor" to mean or intend that the bankrupt shall continue to own or hold the equity of redemption over and above the mortgage down to and including the date when bankruptcy becomes effective. It is, I think, sufficient if it be shown that the bankrupt owned the collateral at the time it was mortgaged or hypothecated, or took the property subject to and assumed to pay such mortgage or other obligation. Once a mortgage always a mortgage. The subsequent deed made by the bankrupt to Yavne was also made expressly subject to the mortgage. So the real estate security for the mortgage remained the same throughout the life of the mortgage, and in fact that security was subsequently [fol. 10] taken by foreclosure. The law is well established in the federal court and in bankruptcy that the value of collateral shall be set off against secured claims; and when Yavne took title, he took subject to all of the legal and equitable implications, among them the right to have the true value of the security applied against the loan: and when the Loan Association makes its claim as it does here, in bankruptcy, the trustee in bankruptcy is entitled to have the value of the collateral credited against the amount due under the foreclosure proceedings. It should be borne in mind that the trustee stands in the place of the bankrupt in a transaction such as this, and surely had there been no bankruptcy proceedings, the Eastern Sash & Door Company would have been entitled to have the true value of the real estate set off in reduction in a deficiency suit.

I am not unmindful of the ruling in re Pan-American Match Company in 242 Fed. 995, nor is my conclusion here in conflict with the ruling in that case, since I hold that the bankrupt has a property in the real estate and that property is a right to have the collateral applied in reduction

of its loan, in this instance the value of the real estate, as against the mortgage money.

An order will therefore be entered, confirming the Referee's report.

Mr. Alboum: May I have an exception?
The Court: Exception allowed.

Which exception is hereby allowed and sealed accordingly.

——— ———, Judge.

[fol. 11] IN UNITED STATES DISTRICT COURT

ORDER DISMISSING PETITION TO REVIEW REFEREE'S ORDER—Filed January 15, 1934

It appearing to the Court that an order was entered November 21, 1933, reducing the claim of the Ivanhoe Building & Loan Association of Newark, N. J., to the sum of $1,739.94 and that the said claimant on November 28, 1933, filed a petition for a review of the Referee's order and after hearing Abraham Alboum, of counsel for the petitioning claimant, and Sydney L. Jacobs, appearing for Charles E. Hendrickson, of counsel for the trustee and it appearing to the satisfaction of the Court that the petition of the Ivanhoe Building & Loan Association of Newark, N. J., should be dismissed and that the order of the Referee reducing the said claim to the sum of $1,739.94 should be confirmed.

It is on this fifteenth day of January, 1934, on motion of Sydney L. Jacobs, appearing for Charles E. Hendrickson, of counsel for Thomas A. Orr, trustee of the above-named bankrupt, Ordered that the petition of the Ivanhoe Building & Loan Association of Newark, N. J., to review filed herein on November 28, 1933, be and the same is hereby dismissed.

And it is further ordered that the order of George W. W. Porter, Esq., Referee herein, dated the twenty-first day of November, 1933, reducing the claim of the Ivanhoe Building & Loan Association of Newark, N. J., to the sum of $1,739.94 be and the same is hereby confirmed.

Guy L. Fake, District Judge.

[fol. 12] IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

[Title omitted]

NOTICE OF FILING PETITION FOR REVIEW—Filed February 14, 1934

Please take notice, that on the fourteenth day of February, 1934, at 10 o'clock A. M., I will file and present for allowance to the Honorable Judges of the United States Circuit Court of Appeals for the Third Circuit, or the clerk of said court in the City of Philadelphia, a petition for review in the above-entitled cause, a copy of which petition is annexed hereto and made part of this notice, and I will then ask to have the same docketed and the necessary order made therein to have such case set down for hearing.

Abraham Alboum, Attorney for Petitioner, 130 Market Street, Newark, New Jersey.

To Charles E. Hendrickson, Esq., Attorney for Trustee, 75 Montgomery Street, Jersey City, New Jersey.

[fol. 13] Service of the within notice and petition for review is hereby acknowledged this thirteenth day of February, 1934, and I hereby consent to the filing and presentment for allowance thereof as of time.

Charles E. Hendrickson, Attorney for Trustee.

IN UNITED STATES CIRCUIT COURT OF APPEALS

PETITION FOR REVIEW—Filed February 14, 1934

To the Honorable Judges of the United States Circuit Court of Appeals for the Third Circuit:

Your petitioner, the Ivanhoe Building & Loan Association of Newark, N. J., appearing by Abraham Alboum, its attorney, respectfully represents that:

1. Your petitioner on review is a corporation duly organized and existing under the laws of the State of New Jersey, with its principal office in the City of Newark,

County of Essex and State of New Jersey, and is a creditor of the above-named Eastern Sash & Door Company, which was duly adjudged bankrupt by the United States District Court for the District of New Jersey on the twenty-third day of April, 1932.

2. After adjudication of bankruptcy the proceedings for the administration of the estate were duly referred to George W. W. Porter, Esquire, Referee in Bankruptcy, before whom the petitioner filed its proof of debt, as an unsecured claimant. On July 12, 1933, the Trustee herein filed a petition for consideration and rejection of said claim, and on July 12, 1933, the Referee in Bankruptcy [fol. 14] made an order directing the petitioner to show cause why the said claim should not be re-examined, rejected and expunged for the reason stated in said petition. Hearings were held before said Referee, at which hearings the same facts were adduced as stated in the stipulation of facts filed herein. And the matter having been duly argued and heard, the said Referee did, on November 21, 1933, make and file an order that the said claim be reduced to $1,739.94 and allowed at said amount upon the list of claims, as a general unsecured claim. A copy of said order is printed in this transcript.

3. Thereupon petitioner filed exceptions to the Referee's said order and on November 28, 1933, the petitioner filed a petition for review of the Referee's said order. Thereafter said Referee filed a certificate of review, as provided by law.

4. Said petition for review came on to be heard before Honorable Guy L. Fake, Judge of the United States District Court, who, upon consideration thereof, did, on January 15, 1934, make an order confirming the Referee's said order. Petitioner duly excepted to the said order, which exception was allowed and sealed accordingly. A copy of said order is printed in this transcript.

5. Your petitioner shows that the said order made by the said Honorable Guy L. Fake, Judge of said District Court, as aforesaid, was erroneous in matter of law, in that:

(a) Petitioner is an unsecured creditor and is entitled to prove its claim in the bankruptcy proceedings for the full amount of its claim, being the deficiency on its bond, less the $100 bid at the sheriff's sale.

[fol. 15] (b) Petitioner is an unsecured creditor and its said claim should have been allowed in full, without any credit or set-off whatsoever for the value of the property in question, for the reason that the said property did not belong to the bankrupt at the time of the said adjudication.

(c) That said order of the United States District Court for the District of New Jersey should have been for your petitioner and not for the Trustee.

(d) That said order of the United States District Court for the District of New Jersey should have reversed the order of the Referee in Bankruptcy.

Wherefore, your petitioner prays that the said order made by said Honorable Guy L. Fake, Judge of the United States District Court for the District of New Jersey, hereinbefore set forth, may be reviewed, revised and reversed by this Honorable Court, in the matters, respects and particulars hereinabove set forth; and that said order may be set aside and for nothing holden; and that the order filed by said Referee, Honorable George W. W. Porter, dated November 21, 1933, may be reversed; and that your petitioner be restored to all things that it may have lost thereby.

And your petitioner, as in duty bound, will ever pray, etc.

Dated January 26, 1934.

Abraham Alboum, Attorney for Petitioner.

[fol. 16] *Duly sworn to by Max E. Fischman. Jurat omitted in printing.*

IN UNITED STATES CIRCUIT COURT OF APPEALS

ORDER ALLOWING PETITION FOR REVIEW TO BE FILED—Filed February 14, 1934

It is ordered that the petition of The Ivanhoe Building & Loan Association of Newark, N. J., for review in the above-entitled cause be filed in this Court and the case placed on the list for argument at the March term of 1934.

Philadelphia.

Dated: February 14, 1934.

J. W. Thompson, Circuit Judge.

[fol. 17] IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

[Title omitted]

ASSIGNMENTS OF ERROR—Filed February 23, 1934

Now comes The Ivanhoe Building & Loan Association of Newark, N. J., appellant, and files this its assignments of error, complaining as follows:

1. The order of the District Court of the United States for the District of New Jersey, made and entered on January 15, 1934, confirming the order of George W. W. Porter, Esquire, Referee in Bankruptcy, reducing the claim herein to $1,739.94, was erroneous in matter of law, in that:

(a) Appellant is an unsecured creditor and is entitled to prove its claim in the bankruptcy proceedings for the full amount of its claim, being the deficiency on its bond, less the $100 bid at the sheriff's sale.

[fol. 18] (b) Appellant is an unsecured creditor and its said claim should have been allowed in full, without any credit or set-off whatsoever for the value of the property in question, for the reason that the said property did not belong to the bankrupt at the time of its adjudication.

(c) That said order of the United States District Court for the District of New Jersey should have been for appellant and not for the Trustee.

(d) That said order of the United States District Court for the District of New Jersey should have reversed the order of the Referee in Bankruptcy.

Abraham Alboum, Attorney for and of Counsel With Appellant.

[fol. 19] UNITED STATES CIRCUIT COURT OF APPEALS
FOR THE THIRD CIRCUIT

March Term, 1934

No. 5434

IVANHOE BUILDING & LOAN ASSOCIATION, Appellant,

vs.

THOMAS A. ORR, Trustee of Eastern Sash & Door Co., Bankrupt, Appellee

Appeal from the District Court of the United States for the District of New Jersey

And now, to wit: this fourth day of April, A. D. 1934, it is ordered that Hon. Albert W. Johnson, District Judge for the Middle District of Pennsylvania, and Hon. William Clark, District Judge for the District of New Jersey, be, and they are hereby assigned to sit in above case in order to make a full court.

J. Warren Davis, Circuit Judge.

Endorsements: Order Assigning Hon Albert W. Johnson and Hon. William Clark for argument. Rec'd and filed Apr. 4, 1934. Wm. P. Rowland, Clerk.

[fol. 20] IN THE UNITED STATES CIRCUIT COURT OF APPEALS
FOR THE THIRD CIRCUIT

March Term, 1934

No. 5434

IVANHOE BUILDING & LOAN ASSOCIATION, of Newark, N. J., Appellant,

vs.

THOMAS A. ORR, Trustee of Eastern Sash & Door Co., Bankrupt, Appellee

And afterwards, to wit, the 4th day of April, 1934, come the parties aforesaid by their counsel aforesaid, and this

case being called for argument sur pleadings and briefs, before the Honorable J. Warren Davis, Circuit Judge, and Honorable Albert W. Johnson and Honorable William Clark, District Judges, and the Court not being fully advised in the premises, takes further time for the consideration thereof.

And afterwards, to wit, on the 3d day of October, 1934, come the parties aforesaid by their counsel aforesaid, and the Court, now being fully advised in the premises, renders the following decision:

[fol. 21] IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

March Term, 1934

No. 5434

IVANHOE BUILDING & LOAN ASSOCIATION, OF NEWARK, NEW JERSEY, Appellant,

v.

THOMAS A. ORR, Trustee of Eastern Sash & Door Company, Bankrupt, Appellee.

Appeal from the District Court of the United States for the District of New Jersey.

Before Davis, Circuit Judge, and Clark and Johnson, District Judges.

OPINION—Filed October 3, 1934

DAVIS, Circuit Judge:

This is an appeal from an order of the District Court reducing the claim of the appellant filed in the bankrupt estate of the Eastern Sash & Door Company by the amount of the value of the collateral which it held.

On July 21, 1927, Abraham Portnoff and others executed to the Ivanhoe Building and Loan Association a bond for the sum of $23,000 conditioned for the payment of $11,500, and to secure the payment thereof, they executed a mortgage on premises known as 386 Leslie Street, Newark, New [fol. 22] Jersey. This property was conveyed to the East-

ern Sash and Door Company, bankrupt, on October 7, 1927, subject to the mortgage, which the bankrupt in the deed expressly assumed and agreed to pay. On the same day the bankrupt conveyed the property to Clara Yavne.

On April 2, 1932, the appellant, Ivanhoe Building and Loan Association, filed a bill to foreclose the mortgage and on June 20, 1932, a final decree was entered in the foreclosure proceeding. The Court found that there was due the appellant on the mortgage the sum of $10,220.96 together with interest and costs. The property was sold by the sheriff and was bid in by the appellant-mortgagee for $100.

On April 23, 1932, the Eastern Sash and Door Company on an involuntary petition was adjudicated a bankrupt and the appellant filed its claim as an unsecured creditor for $10,739.94 which is the difference between the sum found to be due on the mortgage and the $100 which was paid for the property at the sheriff's foreclosure sale. It is admitted by everybody that the market value of the property is $9000 and the question before us is whether or not the appellant must reduce its claim on which it will receive a dividend by that amount, bringing it down to $1,739.94, or whether it is entitled to file it for the $10,739.94, the amount due on the bond less the $100 received at the sale.

The referee and District Court disallowed the claim and held that appellant was entitled to file a claim for only the $1,739.94.

The appellant says that it should be allowed to file for the full amount of its claim of $10,739.94 because it is not a "secured creditor" as defined by Section 1 (23) of the Bankruptcy Act for the reason that it does not have security for its debt upon the property of the bankrupt which conveyed the mortgaged premises to Clara Yavne the same day the property was conveyed to it. This section provides that:

[fol. 23] "a secured creditor shall include a creditor who has security for his debt upon the property of the bankrupt of a nature to be assignable under this act, or who owns such a debt for which some indorser, surety, or other persons secondarily liable for the bankrupt has such security upon the bankrupt's assets."

Section 57 (e) provides that:

"claims of secured creditors * * * shall be allowed for such sums only as to the courts seem to be owing over and above the value of their securities."

Consequently, appellant says, since the title to the mortgaged premises was not in the "bankrupt" and that no person secondarily liable had security on the bankrupt's assets when the petition in bankruptcy was filed, it is not a "secured creditor"; that there were no mutual debts or credits between it and the bankrupt and it does not have to set off its security against the debt, but may file proof for his entire claim.

Remington on Bankruptcy (3rd Ed.), Vol. 2, page 306, Section 917, says:

"Where the property held as security is not the property of the bankrupt, the claim should be allowed without deduction for the value of the securities."

Collier on Bankruptcy (13th Ed.), Vol. 2, page 1144, says that

"the question pertains in each case to the security which a creditor has upon the property of the bankrupt. No matter how great may be the security which one may have, if it be property of another than the bankrupt, the creditor may prove his entire claim against the bankrupt estate, and receive a dividend thereon, and thereafter institute proceedings to enforce his claim upon the security for the balance." [fol. 24] The following authorities are to the same effect. In re Noyes Bros. 127 Fed. 286; In re Keep Shirt Co. 200 Fed. 80; In re Pan-American Match Co., 242 Fed. 995; Manufacturers Acceptance Corporation v. Hale et al., 65 Fed. (2d) 76. Being an unsecured creditor, appellant says that upon these and other authorities, it should have been allowed to prove its entire claim as a basis upon which to calculate its dividend in the bankrupt estate.

It seems to be well settled that security given to the surety by a person other than the bankrupt is not regarded as part of the bankrupt estate and does not increase or "swell" the assets of the estate or exonerate it. An unsecured creditor, not holding security belonging to the bankrupt, may prove his entire claim against the estate and if the dividends received on the claim together with the secur-

ity pledged by a person other than the bankrupt exceed the amount of the claim, the claimant holds the excess as trustee for that other person. Gorman v. Wright, 136 Fed. 164; In the Matter of Hanson & Tyler Auto Co. et al., 286 Fed. 161; Hampel et al. v. Minkwitz, 18 Fed. (2d) 3.

The case of Winter's Appeal, decided by this court, 174 Fed. 556, cited and relied upon by the appellee, is not contrary to this rule of law, for in that case title to the property was in the bankrupt and the claimant admitted that the property, purchased by him at the foreclosure sale, which secured the bond on which the claim was based, was worth more than the amount of the mortgage and costs. Consequently the claim was fully paid and there was no ground for its allowance. In the Matter of Dix, 176 Fed. 582, the claimant, who bid in the property for a nominal sum at a foreclosure sale on mortgages given by the bankrupt, filed his claim against the bankrupt estate for the balance of his debt. The court held that the value of the property purchased should be inquired into and the claim al- [fol. 25] lowed only for the amount equitably due. This case followed the Winter decision, both being based upon the same rule of law and written by Judge McPherson of this court.

But in the case at bar the bankrupt expressly in writing assumed and agreed to pay the mortgage. It then had title to the property which was the security on which the bankrupt assumed the obligation. When the bankrupt conveyed the property to Mrs. Yavne, the transfer did not release it from the obligation to pay the mortgage and it has not been shown that the appellant released the bankrupt. When the mortgage was foreclosed, the obligation of the bankrupt to pay the mortgage still existed, but the appellant-mortgagee purchased the property for a nominal sum. While the obligation of the bankrupt to pay the mortgage still remained, the mortgagee had gotten possession of the security and in enforcing this obligation against the bankrupt, the appellant-creditor must reduce its claim by the admitted value of the security less the $100 paid for it. The bankrupt owed the appellant the amount of the mortgage and the appellant equitably owed the bankrupt the value of the security in his possession. Under these circumstances, Section 68 (a) of the Act applied, which provides that:

"In all cases of mutual debts or mutual credits between the estate of a bankrupt and a creditor the account shall be stated and one debt shall be set off against the other, and the balance only shall be allowed or paid."

The order is affirmed.

A true copy—Teste:
——— ———, Clerk of the United States Circuit Court of Appeals for the Third Circuit.

[fol. 26] IN THE UNITED STATES CIRCUIT COURT OF APPEALS

FOR THE THIRD CIRCUIT

March Term, 1934

No. 5434

IVANHOE BUILDING AND LOAN ASSOCIATION OF NEWARK, NEW JERSEY, Appellant,

vs.

THOMAS A. ORR, Trustee of Eastern Sash & Door Co., Bankrupt, Appellee

Appeal from the District Court of the United States for the District of New Jersey

This cause came on to be heard on the transcript of record from the District Court of the United States for the District of New Jersey, and was argued by counsel.

On consideration whereof, it is now here ordered, adjudged, and decreed by this Court that the order or decree of January 15, 1934, of the said District Court in this cause be, and the same is, hereby affirmed, with costs.

Philadelphia, October 3, 1934.

J. Warren Davis, Circuit Judge.

Endorsements: Order Affirming Order of Jan. 15, 1934. Rec'd and filed Oct. 3, 1934. Wm. P. Rowland, Clerk.

[fol. 27] UNITED STATES OF AMERICA,
Eastern District of Pennsylvania,
Third Judicial Circuit, sct.:

I, Wm. P. Rowland, Clerk of the United States Circuit Court of Appeals for the Third Circuit, do hereby certify the foregoing to be a true and faithful copy of the original Transcript of Record and proceedings in this Court in the case of Ivanhoe Building & Loan Ass'n of Newark, N. J., Appellant, vs. Thomas A. Orr, Trustee of Eastern Sash & Door Co., Bankrupt, Appellee, No. 5434, on file and now remaining among the records of the said Court, in my office.

In testimony whereof I have hereunto subscribed my name and affixed the seal of the said Court, at Philadelphia, this 5th day of November, in the year of our Lord one thousand nine hundred and thirty-four, and of the Independence of the United States the one hundred and fifty-ninth.

Wm. P. Rowland, Clerk of the U. S. Circuit Court of Appeals, Third Circuit. (Seal United States Circuit Court of Appeals, Third Circuit.)

[fol. 26] SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed February 4, 1935.

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Third Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Endorsed on cover: File No. 39,239. U. S. Circuit Court of Appeals, Third Circuit. Term No. 611. The Ivanhoe Building and Loan Association of Newark, N. J., Petitioner, vs. Thomas A. Orr, Trustee of Eastern Sash & Door Company, Bankrupt. Petition for a writ of certiorari and exhibit thereto. Filed December 29, 1934. File No. 611, O. T., 1934.

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BRIEF:

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1934.

No.

THE IVANHOE BUILDING & LOAN ASSOCIATION OF NEWARK, N. J.,

Petitioner,

—against—

THOMAS A. ORR, Trustee of EASTERN SASH & DOOR COMPANY, Bankrupt,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

MAY IT PLEASE THE COURT:

The petitioner, The Ivanhoe Building & Loan Association of Newark, N. J., respectfully prays that a Writ of Certiorari issue to review the decree of the Circuit Court of Appeals for the Third Circuit entered in the above case on October 3, 1934 (R. 24), affirming an Order of the United States District Court for the District of New Jersey (R. 11).

Opinions Below.

The opinion of the Circuit Court of Appeals is printed (R. 20-24) but is not yet reported. The opinion of the United States District Court for the

District of New Jersey is printed (R. 8-10). The order of the Referee in Bankruptcy is printed (R. 6-7).

Jurisdiction.

The decree of the Circuit Court of Appeals was entered October 3, 1934 (R. 24). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of Cong. February 13, 1925, c. 229, 43 Stat. 936.

Questions Presented.

1. Whether an unsecured creditor, not holding security upon property belonging to the bankrupt, may prove its entire claim against the bankrupt estate, without any deduction for the value of the security.

2. Whether Section 1 (23) of the Bankruptcy Act of 1898 [11 U. S. C. A. Section 1 (23)], or whether Section 68 (a) of said Act [11 U. S. C. A. Section 108 (a)] applies to the case at bar.

Statement.

The facts are not in dispute, and are contained in a "Stipulation of Facts" (R. 2-5), and are as follows:

On July 21, 1927, Abraham Portnoff and others executed to the petitioner a bond in the penal sum of $23,000 conditioned for the payment of $11,500, and to secure the payment thereof, said obligors executed to petitioner a mortgage on property known as No.

386 Leslie Street, Newark, New Jersey. On October 7, 1927, said property was conveyed to the bankrupt (R. 2), subject to said mortgage, which the bankrupt in the deed expressly assumed and agreed to pay. On the same day the bankrupt conveyed said property to one Clara Yavne, and she in the deed also expressly assumed and agreed to pay said mortgage (R. 3).

On April 2, 1932, the petitioner filed a Bill against all of said parties to foreclose said mortgage, and on June 20, 1932 a final decree was entered in the foreclosure proceeding, wherein it was decreed that there was due to petitioner, on the mortgage, the sum of $10,220.96, together with interest and costs. The property was sold by the Sheriff and was bid in by the petitioner for $100, leaving a deficiency on said bond in the sum of $10,739.94 (R. 3).

On April 23, 1932, the said Eastern Sash & Door Company, on an involuntary petition, was adjudicated a bankrupt, and on September 28, 1932 the petitioner filed its claim, as an unsecured creditor, for $10,739.94, being the difference between the sum found to be due on said mortgage and the $100 bid at the Sheriff's sale (R. 3-4).

It was admitted that the true value of the property at the time of the Sheriff's sale was $9000 (R. 4). The Referee ordered that the petitioner's claim be reduced to $1,739.94 (R. 6-7). On petition for review of the Referee's order, the United States District Court for the District of New Jersey affirmed the Referee's order (R. 11).

The petitioner thereupon appealed to the United States Circuit Court of Appeals for the Third Circuit, and the said Circuit Court affirmed the order of the District Court (R. 24).

Specification of Errors to Be Urged.

The Circuit Court of Appeals erred:

1. In holding that petitioner must reduce its claim by the admitted value of the security less the $100 paid for it.

2. In holding that said Section 68 (a) of the Bankruptcy Act of 1898 applies to the case at bar.

3. In affirming the Order of the United States District Court for the District of New Jersey.

Reasons for Granting the Writ.

1. The holding of the Court below is in conflict with the applicable decisions of other Circuit Courts of Appeals. *Gorman* v. *Wright,* 136 Fed. 164 (C. C. A. 4th); *Young* v. *Gordon,* 219 Fed. 168 (C. C. A. 4th); *In re Mertens et al.,* 144 Fed. 818 (C. C. A. 2nd); *In re Noyes Bros.,* 127 Fed. 286 (C. C. A. 1st); *Manufacturer's Acceptance Corp.* v. *Hale, et al.,* 65 Fed. (2d) 76 (C. C. A. 6th); *Hampel, et al.* v. *Minkwitz,* 18 Fed. (2d) 3 (C. C. A. 5th).

2. The Court below has decided an important question of general law in conflict with the weight of authority. Collier on Bankruptcy (13th Edition), Vol. 1, p. 28, also Vol. 2, p. 1144; Remington on Bankruptcy (3rd Edition), Vol. 2, p. 306, Sec. 917; *Baker Lumber Co.* v. *Clark Co., et al.,* 178 Pac. 764 (Utah S. C.); *Matter of Anderson,* 11 Fed. (2nd) 380 (D. C. Minn. 6th Div.); *In re Thompson,* 208 Fed. 207 (D. C. N. Y.); *In re Headley,* 97 Fed. 765 (D. C.

Mo.); *In re Shatz*, 251 Fed. 351 (D. C. E. D. Pa.); *In the Matter of West Point Investment Co., Bankrupt*, 19 A. B. R. (N. S.) 572 (D. C. Ga.); *In re Pan-American Match Co.*, 242 Fed. 995 (D. C. Mass.); *In re Keep Shirt Co.*, 200 Fed. 80 (U. S. Dist. Ct., So. Dist. of N. Y.); *Thompson-Ritchie Grocery Co.* v. *Cary, et al.*, 17 La. App. 270, 135 So. Rep. 707 (Ct. of Appeal La., 2nd Cir.); *In the Matter of Hanson & Tyler Auto Co., Bankrupt*, 286 Fed. 161 (U. S. Dist. Ct., Iowa).

3. The Court below has decided an important question of Federal law which has not been, but should be, settled by this Court.

WHEREFORE, your petitioner respectfully urges that the instant petition should be granted, and that your petitioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just; and your petitioner will ever pray.

Respectfully submitted,

MAURICE J. ZUCKER,
Counsel for Petitioner.

BRIEF.

POINT I.

Petitioner should be allowed to file for the full amount of its claim of $10,739.94 because it is not a "secured creditor" as defined by Section 1 (23) of the Bankruptcy Act of 1898, [11 U. S. C. A. Section 1 (23)] for the reason that it does not have security for its debt upon the property of the bankrupt.

The Bankruptcy Act of 1898, Sec. 1, Subd. 23 [11 U. S. C. A. Section 1 (23)] reads as follows:

> "'Secured creditor' shall include a creditor who has security for his debt upon the property of the bankrupt of a nature to be assignable under this Act, or who owns such a debt for which some indorser, surety, or other persons secondarily liable for the bankrupt has such security upon the bankrupt's assets."

The above section *defines* the two classes of creditors, the "secured" and the "unsecured", and a "secured" creditor is one who *has* security for his debt upon the *property of the bankrupt*, owned by the bankrupt *on the date of adjudication*, of a nature such that it will *pass to the Trustee in bankruptcy;* or who is secured by the obligation of another who holds such security; and all others are "unsecured." Collier on Bankruptcy (13th Edition) Vol. 1, page 28, also Vol. 2, page 1144; *Gorman* v. *Wright*, 136 Fed. 164 (C. C. A. 4th); *Young* v. *Gordon*, 219 Fed. 168 (C. C. A. 4th); *Baker Lumber Co.* v. *Clark Co., et al.*, 178 Pac. 764 (Utah S. C.); *Matter of Anderson*, 11 Fed. (2nd) 380 (D. C. Minn. 6th Div.).

The petition in bankruptcy herein was filed and adjudication made on April 23, 1932. *At that time* the bankrupt *was not the owner of the property* on which petitioner held a mortgage, bankrupt having sold said property to one Yavne on October 11, 1927 (R. 3).

Petitioner is, therefore, an "unsecured" creditor.

The rule that where the property held as security for a debt *is not the property of the bankrupt at the time of adjudication,* the claim should be allowed *in full without any deduction for the value of the security,* has been frequently enunciated and followed by the text writers and the Courts.

Remington on Bankruptcy (3rd Edition), Vol. 2, page 306, Sec. 917, says that:

> "Where the property held as security *is not the property of the bankrupt,* the claim should be allowed *without deduction* for the value of the securities." (Italics ours.)

Collier on Bankruptcy (13th Edition), Vol. 2, page 1144, says that:

> "The question pertains in each case to the security which a creditor *has* upon the property of the bankrupt. No matter how great may be the security which one may have, if it be property of *another* than the bankrupt, the creditor may prove his *entire* claim against the bankrupt estate, and receive a dividend thereon, and thereafter institute proceedings to enforce his claim upon the security for the balance." (Italics ours.)

In re Mertens et al., 144 Fed. 818 (C. C. A. 2nd). Creditor of bankrupt held as collateral, property of

one of the individual partners. The Court said, on page 820:

> "* * * The provisions of the present Bankrupt Act requiring secured creditors to surrender preferences, and when the security is not preferential to have its value determined as a condition precedent to the allowance of the claim, *have no application to cases in which the security was not the property of the bankrupt.*" (Italics ours.)

Hiscock v. *Varick Bank*, 206 U. S. 28 (United States Supreme Court), affirms the *Mertens* case above.

In re Thompson, 208 Fed. 207 (D. C.—N. Y.). Bankrupt was indorser on a note. Maker of note deposited with creditor certain shares of stock, not belonging to bankrupt, as collateral security. The Court said, on page 208:

> "* * * the words 'secured creditor', for the purposes of the administration of the bankrupt's estate, are limited to security *out of or against the estate*, * * *." (Italics ours.)

In re Heddley, 97 Fed. 765 (D. C. Mo.), it was held that where a judgment is recovered against two co-defendants, and execution thereon is levied upon the property of one of them, and the other is adjudged bankrupt, the judgment creditor may prove his claim against the bankrupt as unsecured.

In re Shatz, 251 Fed. 351 (D. C. E. D. Pa.), the Court said, at page 354:

> "The definition of a 'secured creditor' is a creditor who *directly holds* as security for his

> debt property *which would otherwise swell the assets of the bankrupt estate,* * * *." (Italics ours.)

In the *Matter of West Point Investment Co., Bankrupt,* 19 A. B. R. (N. S.) 572 (D. C. Ga.), Bankrupt was indorser of notes. Creditor held as collateral, bonds of the maker of the notes, a company in which bankrupt was owner of the majority stock and the company was indebted to bankrupt in excess of the creditor's claims. The Court said, at page 578:

> "* * * It seems to be the consensus of the opinion of the courts that the meaning of 'secured creditors' in Sec. 1 of the Act means that the security that is collateral to the claim *is the property of the bankrupt* and not of a third party * * *."

In re Noyes Bros., 127 Fed. 286 (C. C. A. 1st). Bankrupt was maker of notes indorsed by bankrupt and its treasurer individually, said individual having put up certain collateral security. The Court said, at page 287:

> "It is too late to go to the reason of the rule which permits a creditor whose claim is secured or partly paid by an accommodation indorser to prove the claim to its full amount, and exclude from the bankrupt estate the avails of such security or part payment, because the authorities in this country and England establishing that rule are such that we feel we ought to be governed by them."

In re Pan-American Match Co., 242 Fed. 995 (D. C. Mass.). Bankrupt was maker of note indorsed by third persons. The indorsers put up collateral security. The collateral and the indorsements were of

sufficient value to make payment of the note practically certain. Yet the Court said, at page 996:

> "A creditor's claim may be amply secured, but he is not a 'secured creditor' within the meaning of the Act unless the security is on 'property of the bankrupt.' The reason for such a rule probably is that, when no property of the bankrupt is held as security, the claim is, as to the estate, an unsecured one and may eventually be so presented against it * * *."

The following two cases amplify and strengthen petitioner's contention that no credit need be given for the value of the property in question.

In re Keep Shirt Co., 200 Fed. 80 (U. S. Dist. Ct.—So. Dist. of N. Y.), the facts were as follows: A sold to the bankrupt a bill of goods, payment of which B guaranteed. Later when A pressed B for security B gave him a note of the bankrupt arising upon a separate transaction. Then followed the bankruptcy and A sought to prove upon both claims. The referee allowed proof upon the note in full and upon the bill of goods less the dividend declared on the note. A insisted upon dividends in full on both. The Court said at page 80:

> "The theory of the referee is that as A held the note as security, the dividend must be deducted from the face of the bill of goods, because the dividend constitutes the value of the security (Sec. 57). This would be true enough if the bankrupt had given the security, *but it was not the bankrupt, but a surety of the bankrupt, who gave it.* Thus, if a surety gives property of his own as security to the creditor, it will not inure to the principal's interest, and

if the creditor realize upon it the surety is subrogated as though he had paid." (Italics ours.)

Again on page 81, the Court said:

> "The original error arises from regarding the security as a fund which should exonerate the estate. The statute does not so regard it *unless it be a part of the bankrupt estate itself* (Sec. 1, subd. 23), and the law is well settled that a surety's security does not exonerate the estate. *Re Noyes* (C. C. A., 1st Cir.), 11 A. B. R. 506, 127 Fed. 286, 62 C. C. A. 218; *Re Mertens* (C. C. A. 2nd Cir.), 15 A. B. R. 701, 144 Fed. 818. The referee appears to have been misled into supposing that because the note was made by the bankrupt it was a part of the bankrupt's property. Of course it never was, but was a part of the surety's property. It became security only after he delivered it as a part of his property. Order reversed, both claims to stand in full." (Italics ours.)

In the case of *Manufacturer's Acceptance Corp.* v. *Hale et al.*, 65 Fed. (2d) 76 (C. C. A.—6th), decided in 1933, the claimant held bankrupt's trust deed securing claimant's loan and all other claims of claimant. Claimant purchased bankrupt's unsecured note from a bank shortly before the bankruptcy petition was filed. The claim on the note was allowed as an unsecured claim and the Court said, at page 77:

> "* * * The note in the hands of the bank was unsecured. Its transfer to the appellant added nothing to the bankrupt's assets, nor was its status as an unsecured debt in any way affected by the transfer * * *."

In the case at bar, when the bankrupt purchased the mortgaged premises and assumed payment of the mortgage, it became the principal debtor. When the bankrupt sold the mortgaged premises to Yavne, who also assumed payment of the mortgage, Yavne then became the principal debtor and the bankrupt and the original obligors became sureties. Therefore, on the date of adjudication herein, the bankrupt was a surety and petitioner herein held its mortgage security upon property of the principal debtor (Yavne), a situation similar to the situations in the cases cited, which clearly hold that the value or proceeds of collateral belonging to the principal debtor need not be deducted from the claim against the bankrupt surety. So here, the property belonged to the principal debtor (Yavne) and the value of the same need not be deducted from the claim against the bankrupt surety.

In all of the above cited cases the claims were allowed in full as unsecured. And, the fact that the bankrupt herein was the owner of the property in question several years prior to adjudication is immaterial, which contention the following cases sustain.

Baker Lumber Co. v. *Clark Co. et al.*, 178 Pac. 764 (Utah S. C.). The defendant, Clark Co., made a contract with a school district for the construction of a school, and thereafter assigned to a bank moneys to become due on said contract. Thereafter Clark Co. was adjudicated a bankrupt. The defendants, Ellison and Strong, had claims against the bankrupt for labor performed or materials used in the construction of the school. Complaint prayed that plaintiff and defendants be adjudged to have a prior and superior claim to the fund due from the school district as against the bank. So held and bank appealed. Ellison and Strong had filed proof of their respective

claims in the bankrupt estate as unsecured debts and had received two dividends. It was insisted that the act of so proving their respective claims without reserving the right of enforcing such claims against any security held or to which they were entitled was a waiver against such security and constituted an election to pursue their remedy in the bankruptcy proceedings alone.

The Court said, at page 769:

> "It will be remember that A. A. Clark Co. had assigned all amounts coming to it from the school district to appellant bank shortly before entering into the contract with the school district, and had carried that assignment into effect by delivering the warrants to the bank. *It will thus be seen that at the time of the adjudication in bankruptcy the Clark Co. did not own or have any interest in the fund owing by the school district.* The defendants Ellison and Strong did not therefore, *at the date of such adjudication,* hold any security or claim against the property of the bankrupt. Neither were they secured by the obligation of any one holding such security. They were not secured creditors within the definition quoted, and it was not error to allow judgment against the fund in question for the amount due these claimants * * *." (Italics ours.)

Thus the above case presents a situation where at one time, *prior* to adjudication, the bankrupt had an interest in a fund, which fund stood as security in favor of Ellison and Clark, but that *prior* to the time of adjudication the bankrupt had assigned its interest in said fund. This is similar to the situation in the case at bar, as the bankrupt herein had *at one*

time been the owner of the property in question, but *prior* to the time of adjudication had sold said property.

The case of *Thompson-Ritchie Grocery Co.* v. *Cary et al.*, 17 La. App. 270, 135 So. Rep. 707 (Ct. of Appeal La.—2nd Cir.), decided in 1931, is practically on all fours with the case at bar. On June 30, 1923 plaintiff secured a judgment against S for $472.96 plus interest, which judgment was recorded in the mortgage records and operated as a judicial mortgage on all real property owned by S at the time or subsequently acquired. When plaintiff obtained and recorded the judgment, S was the owner of and in possession of "Blackacre". On April 26, 1924 S sold "Blackacre" to C and on April 12, 1926 C sold an undivided half interest in it to E. In 1927 S filed a petition in bankruptcy and in the early part of 1928 he was adjudicated a bankrupt and all of his property was surrendered and sold and the proceeds distributed among his creditors by the Bankrupt Court. Plaintiff filed his claim in those proceedings and received $94.43 on March 22, 1929, after filing of the suit at law. The suit at law was filed by plaintiff against C and E to collect plaintiff's judgment against S out of the property which he owned at the time the judgment was secured, but which is now owned by C and E. C contended that plaintiff was estopped from pursuing the property because it had filed its claim against S in the bankruptcy proceedings and sought to participate in the bankrupt's estate. The Lower Court entered judgment for the plaintiff, ordering defendants to surrender "Blackacre" to be sold to satisfy plaintiff's debt less amount recovered from the Bankrupt Court. Affirmed by Court of Appeal.

The Court said, at page 709:

> "* * * In all references to property securing a claim against a bankrupt both by the bankrupt act and the authorities, *only property belonging to the bankrupt's estate is included.* We have engaged in the above discussion to show that, even in cases where the law designates the order in which a secured creditor should proceed, it directs that he either proceed first against the security, or ascertain its value before being allowed to share in dividends accruing from the rest of the property. To sustain the exceptions of prematurity would be to hold directly opposite to what the law provides. But in this case the security out of which the plaintiff is endeavoring to collect its debt *is no longer the property of the original debtor, nor is it a part of the bankrupt's estate.* For that reason, the bankrupt court does not govern plaintiff in its efforts to collect its debt out of the said property, *nor is said property in any sense a part of the bankrupt's estate.* Under the law, plaintiff had a perfect right to participate as an unsecured creditor in the bankruptcy proceedings, without reference to the security held, *for the reason that the property held as security is not property of the bankrupt.*" (Italics ours.)

Although the above two cases were not decided in Federal Courts they are cited in the A. B. R. Digest No. 7 (N. S.) 1931-33 on page 382, Sec. 789 under the subject "Creditor holding security against third persons", and are also cited in Colliers 1934 Supplement, page 393 under the subject "(3) Claim secured by other fund or estate or by third party", and as they are the decisions of Courts of Appeal, they lend great support to petitioner's contention.

To respondent's contention that if bankruptcy had not intervened, petitioner, in a deficiency suit against the bankrupt, would be obliged to credit the value of the property against a deficiency, we respectfully submit that, while it is true that the Courts of New Jersey, as well as of many other States, have, during the present economic emergency, relaxed the strict application of their rules and have given unusual relief in deficiency suits, the respondent herein is not in a position to claim any benefit therefrom nor does this change the situation in the instant case. Long before the present emergency it was the settled rule in the Federal Courts and under the Bankruptcy Act that a creditor holding securities must credit the value thereof against his claim, and that a creditor holding a bond secured by a mortgage, must credit the true value thereof against the deficiency regardless of the sale price at the Sheriff's sale. *But the authorities are all in accord that these rules have no application where the bankrupt is not the owner of the property at the time of adjudication and that in such case no credit need be given for the value of the security. The Bankrupt Act Sec. 1 (23) controls.* The authorities I have cited clearly bear this out.

That petitioner is entitled to prove the *full amount* of its claim is further borne out in the following cases:

In the *Matter of Hanson & Tyler Auto Co., Bankrupt,* 286 Fed. 161 (U. S. Dist. Ct., Iowa), petitioner filed an unsecured claim based on promissory notes of bankrupt. One Christian, who had guaranteed bankrupt's indebtedness to petitioner, filed a claim based upon payment to petitioner of the amount of the guaranty, which was less than the amount of the indebtedness due from bankrupt to petitioner.

The Court said, at page 162:

> "* * * In the instant case petitioner, who was the original creditor guaranteed, was not paid his full claim, but only a part, and so far as appears from the record, were he permitted to receive the dividends upon the full amount of his original claim, *there would still be a balance unpaid.* In such circumstances to reduce petitioner's claim to the extent of the guaranty paid and permit the guarantor to prove for the amount so paid *would deprive petitioner of a part of his security and impair the obligation of his contract with the guarantor.*"
>
> * * * * * * * *
>
> "* * * here the party guaranteed *is not yet made whole,* and, as before stated, to permit the guarantor to assume 'the shoes' of petitioner, while petitioner is still bearing a loss, would be to deprive petitioner of the benefit of his contract." (Italics ours.)

Again on page 163, the Court said:

> "* * * In the opinion of the Court the referee erred in his conclusion and order, and should have allowed petitioner's claim and paid the full dividend thereon and disallowed the claim of Christian. Of course, in case the dividend received by petitioner, plus the amount already paid by the guarantor should over pay petitioner, it would leave the surplus held by petitioner as trustee for Christian, and he could recover same in a proper proceeding."

In the case of *Hampel et al.* v. *Minkwitz,* 18 Fed. (2d) 3 (C. C. A.—5th), sureties on a bond of the bankrupt partnership had paid part of the obligation and

it was contended that the sum paid should be deducted from the claim. The Court held that the claimant was entitled to dividends upon the full amount of the claim *"until from all sources he has received full payment."* (Italics ours.)

In re Headley, supra, the creditor held a judgment against the bankrupt and one Coover, and levied upon the stock of Coover and then filed the claim in bankruptcy for the full amount, which the Court allowed. The Court said, at page 771:

> "As the creditor's claim exceeds $12,000 and the alleged claim against Coover is $4,500, *it is hardly probable that his dividend out of the bankrupt's estate in any event would cover the difference."* (Italics ours.)

Petitioner is, therefore, entitled to dividends upon the full amount of its claim.

POINT II.

Section 68 (a) of the Bankruptcy Act of 1898 [11 U. S. C. A. Section 108 (a)], does not apply to the case at bar.

The above section provides that:

> "In all cases of mutual debts or mutual credits between the estate of a bankrupt and a creditor the account shall be stated and one debt shall be set off against the other, and the balance only shall be allowed or paid."

It will be observed that the above section is for the first time invoked in the case at bar by the Circuit Court of Appeals. Up to that time no mention was even made of Section 68 (a) nor did respondent rely upon the provisions thereof.

It is respectfully submitted that in holding that petitioner equitably owed the bankrupt the value of the security, and that Section 68 (a) therefore applies to the instant case, the Circuit Court of Appeals was in error, for the reason that *Section 68 (a) has no application where, as in the case at bar, the bankrupt was not the owner of the property on which petitioner held security.*

A careful search of the authorities has been made to find a case similar to the instant case, in which Section 68 (a) has been applied, but none was found. In all of the cases read, and in those already cited, in which the creditor did not hold security on property belonging to the bankrupt, the Courts applied Section I (23) of the Bankruptcy Act and not Section 68 (a), under the apparent theory that Section 68 (a) did not apply.

However, in the case of *Hiscock* v. *Varick Bank*, 206 U. S. 28, decided in this Honorable Court, and affirming *In re Mertens, et al., supra,* we find that although counsel for appellant therein urged that the provisions of Section 68 (a) should be applied (206 U. S. 34), this Honorable Court, in its decision, did not even mention Section 68 (a), but decided that appellants' contention that the value of the security should be deducted from the claim has no application to cases in which the security is not the property of the bankrupt. See also *In re Keep Shirt Co., supra,* where it was held that Section 57 of the Bankruptcy Act has no application where the security is not the property of the bankrupt.

See also *Gorman* v. *Wright, supra,* frequently cited by the Courts, in which case the bankrupt had endorsed a note and the creditor who held the note also held collateral security of the maker in the form of

certain shares of stock. The lower Court held that the proceeds of the collateral security should be credited against the claim, but the upper Court reversed this conclusion and said, at page 165:

> "* * * The security held by said Gorman was the property of the maker of the note, in which the bankrupt had no interest, and, therefore, under sub-section 23 of Sec. 1 of the Bankruptcy Act of 1898, * * * the claim was properly allowed against the estate of the bankrupt indorser for the full amount due, regardless of said security * * *."

Again on page 165 the Court said:

> "* * * under the bankruptcy law a creditor, to be 'secured', must either hold security against the property of the bankrupt, or be secured by the individual obligation of another who holds such security; and, as it is clearly shown by the record that P. H. Gorman did not come within either of said classes, it must follow that the order requiring the application of the collateral of the principal creditor was treating the claim as secured to that extent, and hence error.
>
> The Court below, in directing that a creditor who has been allowed to prove his claim as an unsecured creditor against the bankrupt indorser must realize and credit the proceeds of collateral securities held by him against the principal debtor before he will be allowed to participate in the distribution of the estate of such indorser, *may have been observing the usual equity rules applicable to the adjustment of similar matters in ordinary proceedings, but in so holding we think that due force and effect was not given to that portion of the Bankruptcy*

Act which defines the two classes of creditors, the 'secured' and the 'unsecured.' We have hereinbefore in effect described the 'secured' debts. All other debts than those so mentioned must be 'unsecured'.

The security held by P. H. Gorman was not the property of the bankrupt, Mathews, and its value is immaterial; for Gorman was entitled not only to prove his entire claim against such bankrupt estate, but also to receive the regular dividends thereon, and then proceed to enforce his claim upon his security. *The equitable rule that a creditor having a lien upon two funds must exhaust that one upon which other creditors have no lien does not apply in cases where it operates to the injury of the party having the double lien, and this rule has, in substance, been made part of the Bankrupt Act.*" (Italics ours.)

In the *Matter of West Point Investment Co., Bankrupts, supra,* to the contention that the bonds put up as collateral by the maker of notes (the indorser was in bankruptcy) should be appraised and sold before the claim was proved, the Court said, at page 579:

"* * * claimants should be permitted to prove their claims *as a proposition of law and equity* (italics ours), although their indebtedness is secured by bonds of the La Grange Lumber & Supply Co., since these bonds are not collateral security *of the bankrupt,* but of the La Grange Lumber & Supply Co., who, as the facts clearly indicate, only served as the third party through whose hands the money passed to satisfy its indebtedness to the West Point Investment Co."

It must be remembered that when the bankrupt sold the property in question to Yavne (R. 3), the bankrupt then received payment for its equity in the property over and above the mortgage, and that the trustee herein, who now stands in the shoes of the bankrupt, although he asks for a credit, has not offered to make the petitioner *whole*, as in equity and good conscience should be done.

It is further respectfully submitted that in the foreclosure sale of the property in question nothing was taken from the bankrupt estate, as the property did not belong to the bankrupt on the date of adjudication.

It is respectfully submitted that petitioner is entitled to prove its claim in *full* and that to reduce the claim to $1,739.94 and pay dividends on that amount only would deprive petitioner of a part of its security and impair the obligation of its contract (the bond). It would certainly be inequitable to allow the claim at that amount only. The payment of dividends even on petitioner's entire claim would probably not give petitioner more than full payment of its claim.

It is respectfully submitted that Section 68 (a) does not apply in the case at bar and that according to law and equity the petitioner's claim should be allowed in full, without any credit for the value of the property.

Respectfully submitted,

ABRAHAM ALBOUM,
Attorney for Petitioner.

MAURICE J. ZUCKER,
Counsel for Petitioner.

ABRAHAM ALBOUM,
AARON NAROL,
On the Brief.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1934.

No. 611.

THE IVANHOE BUILDING & LOAN ASSOCIATION OF NEWARK, N. J.,

Petitioner,

—against—

THOMAS A. ORR, Trustee of EASTERN SASH & DOOR COMPANY, Bankrupt,

Respondent.

ON CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

SUPPLEMENTAL BRIEF FOR PETITIONER.

In reply to respondent's supplemental brief, petitioner respectfully submits that:

The cases cited by respondent do not sustain his contentions, but rather support petitioner.

The very first case cited by respondent—*Green* v. *Stone*—54 New Jersey Equity 387, decided in our highest Court, employs significant language in petitioner's favor. In addition to the wording cited in respondent's brief, *in favor of the creditor,* the Court said, on page 395:

> "* * * The legal effect of such a covenant (to assume and pay the mortgage) is not

changed by the fact that the remedy upon it is sought in a court of equity. *The covenant has the same efficacy in a Court of equity as in a court of law,* * * *" (Words in parenthesis and italics ours.)

As to the second group of cases cited by respondent (p. 4, Supplemental Brief), the principle underlying all of these cases is that, *so long as the decree in the foreclosure suit and the confirmation of the sale thereunder stand undisturbed, the mortgagee may sue for and recover the entire deficiency.* In the case at bar the decree in the foreclosure suit was entered on June 20, 1932. The Sheriff's sale which was held on August 9, 1932 was confirmed by the Court of Chancery on August 20, 1932, and, up to the present time, neither said decree nor said confirmation of sale have been in any way questioned or attacked and they now stand undisturbed and in full force and effect.

It will thus be seen that even in a suit in equity petitioner would have been entitled to recover the *full amount* of the deficiency.

Respondent makes every effort to confuse the issues herein. He first contends that petitioner's claim should be considered as *in equity.* Then, in his oral argument, he cited a statute of the State of New Jersey which established a method of procedure in suits *at law,* and, although he admits that this statute was declared unconstitutional as to pre-existing contracts, he now again cites this statute (Chapter 82, Laws of 1933) in his supplemental brief (p. 5). This statute has no bearing upon the case at bar.

Although the Court below decided this case on the theory that Section 68 (a) of the Bankruptcy Act applies, with which he agrees in his main brief, respondent now seems to be dissatisfied with the theory

of the Court below and now contends that Section 57 (k) of the Bankruptcy Act governs this case. It is respectfully submitted that to allow petitioner to receive dividends on the full amount of its claim does not violate Section 57 (k) but in fact is treating the claim "according to the equities of the case".

Respondent puts the question, "Should petitioner be entitled to any greater right after bankruptcy than it had before?" It is respectfully submitted that petitioner is asking for no greater right than in equity and good conscience it is entitled to. According to the authorities petitioner is entitled to be made *whole*. To reduce the claim by the value of the property and pay dividends on the net amount only would have the effect of giving a preference and advantage to the other creditors. **Would this be treating the claim "according to the equities of the case?"** Most certainly not.

In his brief and argument in the Court below respondent argued that petitioner is a *secured* creditor. In his main brief herein (p. 11) he states that "We are not dealing in this case with a situation involving secured creditors." He now contends that "the question whether or not petitioner is a secured or unsecured creditor is beside the point" (p. 5, Supplemental Brief).

Petitioner emphatically contends that this question is of the utmost importance; that petitioner is an *unsecured* creditor, for the reason that bankrupt was not the owner of the property on the date of adjudication, and that Section 1 (23) of the Bankruptcy Act applies to and governs the case at bar.

It is only because petitioner *is an unsecured creditor* and because respondent knows that an unsecured creditor, not holding security on the property of the bankrupt, may prove the *entire* claim without deduc-

tion for the value of the security, that respondent is invoking these other theories.

At the oral argument petitioner referred to two cases, not cited in its main brief, and petitioner begs leave to mention them herein.

The first case is that of *In re Kinne, Bankrupt*, 5 Fed. 59, decided in 1880 in the District Court for the District of New Jersey. The second case is that of *Bankers' Trust Co.* v. *Irving Trust Co.*, 73 Fed. (2nd) 296, decided by Judge Manton in the Circuit Court of Appeals for the Second Circuit on November 5, 1934.

It is significant that the Trustee in the last mentioned case applied to this honorable Court for a writ of certiorari at this Term of the Court (#584) and that his application was denied.

Both of the above cases clearly bear out petitioner's contention that it is entitled to prove the full amount of its claim and receive dividends thereon.

As to the theory of the Court below that Section 68 (a) of the Bankruptcy Act applies to the case at bar, petitioner respectfully submits that there is not here presented a case of mutual debts or mutual credits.

In the case of *McDaniel Nat. Bank* v. *Bridwell*, 74 Fed. (2d) 331 (C. C. A. 8th), decided November 1934, the Court said, on page 332:

> "From the wording of this subsection it is evident that, before a creditor may enjoy the use of the set-off principle against the bankrupt's estate, two essential elements must be established: (1) Two debts must exist, one of the creditor and one of the bankrupt's estate. (2) These debts must be mutual, *i. e.*, the

creditor's debt must be owed to the estate of the bankrupt, and the estate's debt must be owed to this creditor.

* * * * * * * * *

If such conditions are not fulfilled and the required mutuality is lacking, set-off is impossible under the statute. * * *

* * * Case had parted with title to the money represented in the certificates. There was no mutuality of debts and credits between Case and the bank when the petition was filed which is the time when the right of set-off must be measured."

When we remember that the filing of the petition is the crucial time in all matters arising in Bankruptcy proceedings (when, as here, adjudication follows) then the error of the statement of the Court below that petitioner "owed the Bankrupt the value of the security", is strikingly apparent, for, on the date of adjudication herein petitioner did not owe the bankrupt anything.

Section 68(a) of the Bankruptcy Act does not, therefore, apply to the case at bar.

Petitioner respectfully submits that the decree of the Circuit Court of Appeals should be reversed.

Respectfully submitted,

ABRAHAM ALBQUM,
Counsel for Petitioner.

ABRAHAM ALBOUM,
AARON NAROL,
On the Brief.

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IN THE

Supreme Court of the United States,

OCTOBER TERM, 1934.

No. 611.

THE IVANHOE BUILDING & LOAN ASSOCIATION OF NEWARK, N. J.

Petitioner,

—against—

THOMAS A. ORR, Trustee of EASTERN SASH & DOOR COMPANY, Bankrupt.

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS, THIRD CIRCUIT.

BRIEF FOR THE RESPONDENT, THOMAS A. ORR, Trustee of EASTERN SASH & DOOR COMPANY, Bankrupt, IN OPPOSITION.

CHARLES E. HENDRICKSON,
Attorney for Respondent.

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IN THE

Supreme Court of the United States,

OCTOBER TERM, 1934.

No. 611.

THE IVANHOE BUILDING & LOAN ASSOCIATION OF NEWARK, N. J.,

Petitioner,

—against—

THOMAS A. ORR, Trustee of EASTERN SASH & DOOR COMPANY, Bankrupt,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF FOR THE RESPONDENT, THOMAS A. ORR, TRUSTEE OF EASTERN SASH & DOOR COMPANY, BANKRUPT, IN OPPOSITION.

Opinions Below.

The opinion of the Circuit Court of Appeals is printed (R. 20-24) but is not yet reported. The opinion of the United States District Court for the District of New Jersey is printed (R. 8-10). The order of the Referee in Bankruptcy is printed (R. 6-7).

Jurisdiction.

The decree of the Circuit Court of Appeals was entered October 3, 1934 (R. 24). The Petitioner attempts to invoke

the jurisdiction of this Court under the authority of Section 240 (a) of the Judicial Code, as amended by the Act of Congress, February 13, 1925, c. 229, 43 Stat. 936.

In reply to the petition for a writ of certiorari, the respondent respectfully submits to this honorable court that neither the facts nor the state of the decisions applying to the facts with respect to the Bankruptcy Act and such law as pertains to it, constitute any reason whatsoever to reconsider on certiorari, the decision of the Circuit Court of Appeals for the Third Circuit. This is an ordinary case arising under the Bankruptcy Act, the decision of which, by the circuit Court of Appeals for the Third Circuit, is neither in conflict with the decisions of other circuit courts of appeal nor in conflict with the weight of authority on the subject. There being no ground for a technical appeal or writ of error, there is also, because of the above reasons, no ground for a writ of certiorari.

The respondent also respectfully insists that under the interpretation of the Statutes of Congress now subsisting, this Honorable Court has been, through the amendment of the Bankruptcy Act, deprived by Congress of jurisdiction to hear on certiorari, this subsisting litigation already decided by the Circuit Court of Appeals for the Third Circuit.

Questions Presented.

1. Whether the Supreme Court of the United States should exercise jurisdiction to review the decision of the Circuit Court of Appeals in affirming the order of the United States District Court for the District of New Jersey reducing the claim of the petitioner.

2. Whether a Court of Bankruptcy may refuse the claimant any right to share or may reduce the amount upon which he may take contribution in dividends on the ground that claimant has obtained satisfaction in whole or in part out of the property pledged as collateral security by some third person especially where the bankrupt is not primarily liable for the indebtedness.

Statement.

The facts are not in dispute and are contained in "Stipulation of Facts" (R. 2-5) and are substantially set forth in the Petition (pp. 2-3).

Summary of Argument.

1. THE SUPREME COURT OF THE UNITED STATES SHOULD NOT REVIEW THE DECISION OF THE CIRCUIT COURT OF APPEALS.

2. THE COURT OF BANKRUPTCY WAS JUSTIFIED IN REDUCING THE PETITIONER'S CLAIM.

ARGUMENT.

I.

The Supreme Court of the United States should not review the decision of the Circuit Court of Appeals.

Prior to 1925 the appellate jurisdiction of the Supreme Court of the United States in Bankruptcy matters was governed by sections 24 (a) and 25 (b) of the Bankruptcy Act. Section 24 (a) is as follows:

> The Supreme Court of the United States, the Circuit Courts of appeal of the United States, the Court of Appeals of the District of Columbia, and the Supreme Courts of the Territories, in vacation, in chambers and during their respective terms, as now or as they may be hereafter held, are hereby invested with appellate jurisdiction of controversies arising in bankruptcy proceedings from the Courts of Bankruptcy from which they have appellate jurisdiction in other cases.

Section 25 (b) is as follows:

> b. From any final decision of a Court of Appeals allowing or rejecting a claim under this Act, an appeal

may be had under such rules and within such time as may be prescribed by the Supreme Court of the United States, in the following cases and no other:

1. Where the amount in controversy exceeds the sum of two thousand dollars, and the question involved is one which might have been taken on appeal or writ of error from the highest court of a state to the Supreme Court of the United States.

2. Where some Justice of the Supreme Court of the United States shall certify that in his opinion the determination of the question or questions involved in the allowance or rejection of such claim is essential to a uniform construction of this Act throughout the United States.

Both Sections 24 (a) and 25 (b) of the Bankruptcy Act have been repealed by the Act of Congress of February 13, 1925, c. 229, 43 Stat. 941, so far as they regulate the mode of review by the Supreme Court in the proceedings, controversies and cases therein named.

The right of appeal in Bankruptcy matters is now governed by Section 25 (a) of the Bankruptcy Act.

Section 25 (a) is as follows:

a. That appeals, as in equity cases, may be taken in bankruptcy proceedings from the Courts of Bankruptcy to the Circuit Courts of Appeal of the United States and the Court of Appeals of the District of Columbia and to the Supreme Courts of the Territories in the following cases, to wit: (1) From a judgment adjudging or refusing to adjudge the defendant a bankrupt; (2) from a judgment granting or denying a discharge; and (3) from a judgment allowing or rejecting a debt or claim of $500 or over. Such appeal shall be taken within thirty days after the judgment appealed from has been rendered, and may be heard and determined by the appellate Court in term or vacation, as the case may be.

Prior to 1925, the Supreme Court of the United States would not have entertained jurisdiction to review the decision in the instant case for the reason that no federal ques-

tion is presented which would sustain a writ of error to a state court. *Chapman* v. *Bowen*, 207 U. S. 89, *Central Trust Co.* v. *Chicago Auditorium Ass'n.*, 240 U. S. 581, 36 Sup. Ct. Rep. 412.

In the case of *Chapman* v. *Bowen, supra*, the Court held:

> "A decision of a Circuit Court of Appeals that a creditor is entitled to have his claim allowed against the bankrupt estate of an individual partner, as well as against the estate of the bankrupt partnership, which proceeds upon a well settled principle of general law broad enough to sustain it without reference to the provisions of the Bankruptcy Act of July 1st, 1898, (30 Stat. at L. 544, c. 541 U. S. C. Title 11, sec. 1) is not reviewable in the federal Supreme Court under section 25 b of that act as involving a question which would sustain a writ of error to a state court."

In the case of *Central Trust Co.* v. *Chicago Auditorium Ass'n., Supra*, the Court held:

> "A decision of a Circuit Court of Appeals that a claim against a bankrupt estate for damages growing out of the anticipatory breach of an executory contract while allowable as a provable debt for the term during which that court thought that the contract was mutually obligatory should not be allowed beyond that period, is not reviewable in the Federal Supreme Court under the Bankrupt Act of July 1st, 1898 (30 Stat. at L. 553, c. 541 U. S. C. Title 11, Sec. 48) Sec. 25 b 1 as presenting a federal question which would sustain a writ of error to a state court.

The respondent respectfully submits that the review by the Supreme Court contemplated by Section 240 (a) of the Judicial Code as amended by the Act of Congress, February 13, 1925, c. 229, 43 Stat. 936, does not apply to matters in Bankruptcy.

Section 240 (a) of the Judicial Code is as follows:

> In any case, civil or criminal, in a Circuit Court of Appeals, or in the Court of Appeals of the District of

Columbia, it shall be competent for the Supreme Court of the United States, upon the petition of any party thereto, whether Government or other litigant, to require by Certiorari, either before or after a judgment or decree by such lower court, that the cause be certified to the Supreme Court for determination by it with the same power and authority, and with like effect, as if the cause had been brought there by unrestricted writ of error or appeal.

II.

The court of bankruptcy was justified in reducing the petitioner's claim.

On July 21, 1927, Abraham Portnoff et als. executed to the petitioner a bond in the sum of $23,000. conditioned for the payment of $11,500. and interest thereon at the rate of 6% per annum. To secure the payment of the bond, the obligors executed to the petitioner a mortgage covering premises known as 386 Leslie Street, Newark, N. J.

On October 7, 1927, the obligors conveyed the premises to the bankrupt, which deed was recorded on October 11, 1927. In that deed, the bankrupt expressly assumed and agreed to pay the mortgage. By a deed dated October 11, 1927, the bankrupt conveyed the said premises to one, Clara Manasevit, now Clara Yavne. In that deed, the grantee expressly assumed and agreed to pay the mortgage.

On April 2, 1932, the petitioner filed a bill to foreclose the mortgage and on June 20, 1932, a final decree was entered. On August 9, 1932, the premises were sold by the Sheriff of Essex County to the petitioner for the sum of $100.

On April 23, 1932, Eastern Sash & Door Company was adjudged a bankrupt. Petitioner filed claim in the sum of $10,739.94, as an unsecured claim, which represents the difference between the amount of the final decree, interest and costs and the amount received at the sheriff's sale.

Respondent claims that the value of the property should be set off from the amount of the petitioner's claim. Petitioner has received payment of its claim to the extent of $9,000. which is the admitted value of the premises in question.

In the case of *Federal Title & Mortgage Guaranty Co.* v. *Lowenstein,* 113 N. J. Eq. 200, 166 Atlantic 538, Vice Chancellor Berry said:

> "The present sale being in effect a strict foreclosure, the ancient practice of appraising the property for the purpose of fixing the deficiency, originally adapted for the protection of the mortgagee, should now be invoked for the protection of the mortgagor. 'Equality is Equity.' It would be unjust to permit the mortgagee to extort double satisfaction from the mortgagor, and it would be equally unjust to compel the mortgagee to accept inadequate security in satisfaction of his debt. But it is considered no injustice to the mortgagee when a judicial sale of mortgaged premises accomplishes no more than a strict foreclosure to revert to the English practice referred to and require the mortgagee to accept the security at its fair value and give him the right to proceed on the bond for the deficiency. In this manner both parties are protected and exact justice is accomplished. The same result has been reached in this country upon a foreclosure by entry and possession. Armory v. Fairbanks, 3 Mass. 562 (1793); West Chambers, 25 Mass. 138, 3 Am. Dec. 98. In Armory v. Fairbanks, it was held that after foreclosure the estate may be valued and the mortgagee may then be deemed to have received payment pro tanto.
>
> One of the maxims lying at the very foundation of equitable jurisprudence is that 'equity will not suffer a wrong without a remedy.'
>
> The mortgagee will not be permitted to retain the estate which will, in effect, become absolute in him upon confirmation of the foreclosure sale and also recover the debt which is the consideration of that estate by an action on the bond, except and until he credits upon that bond the fair value of the mortgaged premises so acquired by him."

The state law governing such situations is binding upon the federal courts. *Hiscock* v. *Varick*, 206 U. S. 28.

The case of *In the Matter of Graves*, 20 Am. B. R. 818, is practically identical with the instant case. In that case a note was made by Vail Light & Lumber Co. to the order of Graves. Graves indorsed this note to the claimant. As security for the note the Vail Company gave Graves a bond and mortgage which Graves assigned to the claimant. Graves then filed a petition in Bankruptcy. The claimant foreclosed the mortgage and then filed claim for the deficiency against the Estate of Graves in bankruptcy. The Court held as follows:

> "Sec. 57H providing for the valuation of non-preferential securities held by secured creditors does not apply where the securities were not the property of the bankrupt, and where he is endorser upon a corporation note and the proof of claim sets forth that the note is secured by a mortgage on both the real and personal property of the maker. The Bankruptcy Court has no jurisdiction over the mortgaged property except to ascertain its value and to see to its proper application in payment of the note when presented for allowance against the bankrupt's estate.
>
> The Court of Bankruptcy in the exercise of its equitable powers may refuse the claimant any right to share or may reduce the amount upon which he may take contribution in dividends, on the ground that he has obtained satisfaction, in whole or in part, out of the property pledged as collateral security by some third person.
>
> Mr. Clement was entitled to prove his claim for the amount due thereon, but having foreclosed on the property of another and obtained full and complete possession thereto, he should have dividends only on the balance after deducting the value of the mortgaged property which he has received from the corporation which is his principal debtor.
>
> The cause is referred back to the Referee to find the balance due on the said note after deducing the value of the property covered by said mortgage and taken under said decree."

In the Matter of Teitenberg, 15 Am. B. R. (N. S.) 580.

"Where a claim on a deficiency judgment on a foreclosure action has been entered, the Bankruptcy Court may inquire into the judgment and where the claimant bought in the property for an inadequate amount the claim will be allowed for the amount equitably due."

In the Matter of Dix, 186 Fed. 582.

Where the holder of mortgages given by a bankrupt foreclosed and bid in the property for a nominal sum, there being no competing bid, on his filing a claim against the bankrupt estate for the balance of his debt, the actual value of the property may be inquired into and his claim will be allowed only for the amount equitably due.

In the case of *Winter's Appeal,* 174 Fed. 556, decided by the Circuit Court of Appeals for the Third Circuit, the title to the property was in the bankrupt and the claimant admitted that the property, purchased by him at the foreclosure sale, which secured the bond on which the claim was based, was worth more than the amount of the mortgage and costs. Consequently the debt was fully paid and the claim was disallowed as paid by the foreclosure.

This matter can be viewed in a different way. At the time of the adjudication herein this petitioner had an unliquidated claim which could not be filed until it was liquidated in accordance with the provisions of the Bankruptcy Act. Section 63 b of the Bankruptcy Act provides:

"Unliquidated claims against the bankrupt may, pursuant to application to the Court, be liquidated in such manner as it shall direct and may thereafter be proved and allowed against his estate."

The usual method of liquidating a claim such as the one here in question would be a suit in the Court of Chancery of New Jersey against the corporation now bankrupt, based upon the equitable rights which arise in such situations.

Because of the intervention of bankruptcy the creditor's right to proceed in the State Court is lost and instead the creditor must file a claim on the bond in the Federal Court and there liquidate it. *In re McAusland,* 235 Fed. 173.

The Trustee's application to expunge or reduce the petitioner's claim was, in essence, a liquidation of the amount due and carries with it an application to have it liquidated in accordance with the authority given under section 63 b of the Bankruptcy Act.

If we proceed to liquidate the claim in question in accordance with the rule enunciated by the New Jersey Court of Chancery in the case of *Federal Title & Mortgage Guaranty Co.* v. *Lowenstein, supra,* the value of the property which has been admitted to be the sum of $9,000. must be set off against the amount of the petitioner's claim leaving a balance of $1,739.94 for which sum the claim was allowed as a general unsecured claim.

This matter can be viewed in another light. The relationship which the bankrupt bore was that of surety for the payment of the debt owed by Clara Yavne as principal.

In 50 C. J. 74 it is said:

> "The liability of a surety is co-extensive with that of a principal."

The filing of the claim by the creditor is similar to a suit on the bond and under the case of *Federal Title & Mortgage Guaranty Co.* v. *Lowenstein, supra,* the liability of the principal in such suit would be the difference between the deficiency and the fair market value of the property.

The principal in such suit could set up the defense of partial payment. In the case of *American Bonding Co.* v. *United States,* 233 Fed. 364, it was held that a surety can set up the same defense that a principal could.

In 50 C. J. 102 it is said:

> "Partial payment does not discharge the surety completely. It is, however, a discharge of his liability to the extent of the payment made, as where the surety

> is discharged pro tanto by payment from the principal to the creditor, or by payments of the proceeds from security received by the creditor."

This matter can be viewed in still another way. When the mortgage was foreclosed the obligation of the bankrupt to pay the mortgage still existed but the petitioner, mortgagee, purchased the property for a nominal sum. While the obligation of the bankrupt to pay the mortgage still remained, the petitioner had gotten possession of the security and in enforcing this obligation against the bankrupt, the petitioner must reduce its claim by the admitted value of the security, less the $100. paid for it. The bankrupt owed the petitioner the amount of the mortgage and the petitioner equitably owed the bankrupt the value of the security in his possession.

Under these circumstances, Section 68 (a) of the Bankruptcy Act applied. This section is as follows:

> "In all case of mutual debts or mutual credits between the estate of a bankrupt and the creditor, the account shall be stated and one debt shall be set off against the other and the balance only shall be allowed or paid."

The cases cited by the petitioner do not apply to the instant case. We are not dealing in this case with a situation involving *secured creditors.* Respondent contends that the petitioner has received payment of its claim to the extent of $9,000. and that the claim must be reduced by that sum. This conclusion is fully justified from a reading of the cases cited herein.

CONCLUSION.

The Circuit Court of Appeals for the Third Circuit, as well as the United States District Court, rendered an eminently fair and just decision. There appears to be no conflict of decisions and no reason for granting the writ, the instant petition fails to present any questions of general importance or any constitutional questions of wide general interest. The petition should be denied.

Respectfully submitted,

CHARLES E. HENDRICKSON,
Attorney for Respondent.

SAUL NEMSER,
Counsel for Respondent.

CHARLES E. HENDRICKSON,
SYDNEY L. JACOBS,
On the Brief.

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IN THE

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OCTOBER TERM, 1934

No. 611

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Petitioner

against

THOMAS A. ORR, TRUSTEE OF EASTERN SASH & DOOR COMPANY, Bankrupt

Respondent

ON CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

Supplemental Brief for the Respondent, Thomas A. Orr, Trustee of Eastern Sash & Door Company, Bankrupt

CHARLES E. HENDRICKSON
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ON CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

Supplemental Brief for the Respondent, Thomas A. Orr, Trustee of Eastern Sash & Door Company, Bankrupt.

This supplemental brief is filed pursuant to leave granted by the Court upon the oral argument on April 5, 1935.

Nature of Petitioner's Claim.

If the assuming grantee (the bankrupt) had not been adjudicated a bankrupt but on the contrary was a live going concern, the petitioner would have neither right nor remedy *at law* for the recovery of the deficiency arising out of the foreclosure. Petitioner's remedy against the assuming grantee is purely an equitable one. There is no privity between the creditor mortgagee and the assuming grantee. The creditor mortgagee could pursue the assuming grantee only through the original obligor grantor and in the State of New Jersey, where the Court of Chancery which administers equity is separate and distinct from the Courts of Law, the petitioner's sole forum would be in the equity court, and then only in accordance with "the ancient and familiar doctrine in equity that the creditor shall have the benefit of any obligation or security given by the principal to the surety for the payment of the debt." *Green* v. *Stone*, 54 New Jersey Equity 387.

> "A deed inter partes whereby an estate is conveyed, if accepted by the grantee, is in legal effect the deed of both parties, and a stipulation in such a deed by the grantee that he will assume and pay a debt secured by a mortgage on the premises for the payment of which the grantor is personally liable, is a contract by the grantee with the grantor to pay the mortgage debt, especially where the mortgage debt is computed as part of the consideration money for the conveyance. This contract is with the grantor for his indemnity, and the obligation of the grantee to pay the debt enures in equity for the benefit of the mortgagee, *and he may enforce it against the grantee to the extent of the unpaid part of the mortgage debt remaining due after the proceeds of the mortgaged estate have been applied thereon.*" (Italics ours.)

Green v. *Stone, supra,* and cases cited therein; *Holland Reform School Society* v. *De Lazier,* 85 N. J. Eq. 497; *Reeves* v. *Cordes,* 108 N. J. Eq. 469, 155 Atlantic 547; *Feitlinger* v. *Heller,* 112 N. J. Eq. 209, 164 Atlantic 6; *Uptown B. & L. &c.* v. *Leff,* 112 N. J. Eq. 543, 165 Atlantic 118; *Fisk* v. *Wuensch,* 115 N. J. Eq. 391, 171 Atlantic 174; *Keller* v. *Ashford,* 133 U. S. 610.

The point we desire to emphasize is that petitioner's claim is essentially equitable in its nature and in New Jersey could be enforced, if at all, only in a court of equity. Hence the petitioner by filing its claim has invoked the equitable jurisdiction and powers of the Bankruptcy Court and is bound by the fundamental equitable maxims that "he who seeks equity must do equity" and that in the administration and liquidation of insolvent estates "equality is equity".

It has been stipulated in the case at bar that the fair value of the real estate against which petitioner has foreclosed and which has been reduced to petitioner's possession, is the sum of $9,000.00. The value of the property, in equity and good conscience, should be offset against the alleged deficiency and the petitioner should only be entitled to receive dividends on the *net* amount then remaining due.

The petitioner has title to the property and has, therefore, *in equity,* been paid the sum of $9,000.00. To permit petitioner to file its claim for the full amount and at the same time utterly disregard the value of the collateral which it has reduced to its possession and which is conceded to be worth $9,000.00, would in effect be granting to petitioner a preference over all other creditors of the bankrupt estate. Petitioner would then be receiving dividends on the sum of $9,000.00 which has already been paid to it.

The New Jersey rule regarding deficiency judgments after foreclosure.

The first case to enunciate the rule regarding deficiency judgments in the State of New Jersey during the present economic emergency is the case of *Federal Title & Mortgage Co.* v. *Lowenstein*, cited on page 7 of respondent's original brief. The doctrine of this case has been followed in the following New Jersey cases: *Fifth Ave. Bank of N. Y.* v. *Compson*, 113 N. J. Eq. 152; *Baader* v. *Mascellino*, 113 N. J. Eq. 189; *United B. & L. Ass'n* v. *Neuman*, 113 N. J. Eq. 245; *Lurie* v. *Hockenjos*, 113 N. J. Eq. 504, aff. 115 N. J. Eq. 304; *Federal Realty Co.* v. *Fidelity Corp. of N. J.*, 113 N. J. Eq. 356; *Chasey* v. *Broadway Holding Co.*, 114 N. J. Eq. 74; *Better Plan B. & L. Ass'n* v. *Holden*, 114 N. J. Eq. 537; *Fruzynski* v. *Phillips*, 114 N. J. Eq. 23; *Keer* v. *N. J. Title Guarantee, &c., Co.*, 115 N. J. Eq. 388; *Meranus* v. *Lawyers & Homemakers B. & L. Ass'n*, 116 N. J. Eq. 402, 174 Atlantic 150; *Maher, et als.* v. *Usbe*, 116 N. J. Eq. 398, 174 Atlantic 159; *Fisk* v. *Wuensch, supra; Fruzynski* v. *Jablonski*, 117 N. J. Eq. 117; *Young* v. *Weber*, 117 N. J. Eq. 242, 175 Atlantic 273.

The extent to which the New Jersey Court of Chancery has gone in cases involving deficiencies after foreclosure and in invoking the maxim "he who seeks equity must do equity" is strikingly illustrated in the case of *Baader* v. *Mascellino, supra*, where the Court of Chancery of New Jersey refused to set aside a fraudulent conveyance unless the creditor mortgagee as a condition precedent to his obtaining equitable relief, should credit against the deficiency the fair value of the premises. The Court followed the doctrine of the case of *Federal Title & Mortgage Co.* v. *Lowenstein, supra.*

The same doctrine has been applied by the Equity Courts of New Jersey for the benefit of assuming grantees. *Better Plan B. & L. Ass'n* v. *Holden, supra; Fisk* v. *Wuensch, supra,*

The foregoing rule, as applied in the Equity Courts of New Jersey, was created by statutory enactment, for application in the *Courts of Law,* but this statute was held unconstitutional as being repugnant to and in violation of the Constitution of the United States, with respect to pre-existing contracts. *Vanderbilt* v. *Brunton Piano Co.,* 111 N. J. L. 596.

Conclusion.

The petitioner filed its claim as an unsecured creditor. If bankruptcy had not intervened, the petitioner could only have sued the bankrupt concern in a court of equity and then only for the balance of the deficiency after deducting the fair value of the premises. By filing its claim with the Referee in Bankruptcy, the petitioner has in effect asked the Court of Bankruptcy to ascertain the amount of the deficiency as against the Bankrupt. This the Court of Bankruptcy has done. **Should the petitioner be entitled to any greater right after bankruptcy than it had before?** The question of whether or not the petitioner was a secured or unsecured creditor is quite beside the point as we see it. The Court of Bankruptcy has determined the amount of petitioner's claim against the bankrupt "according to the equities of the case" as it is empowered to do under Section 57K of the Bankruptcy Act, and in doing so, has applied the rules of equity clearly applicable to such situations.

It is respectfully submitted that the order appealed from should be affirmed.

Respectfully submitted,

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On the Brief.

SUPREME COURT OF THE UNITED STATES.

No. 611.—October Term, 1934.

The Ivanhoe Building & Loan Association of Newark, N. J., Petitioner,
vs.
Thomas A. Orr, Trustee of Eastern Sash & Door Company, Bankrupt.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Third Circuit.

[April 29, 1935.]

Mr. Justice Roberts delivered the opinion of the Court.

In this case the question is whether a creditor of a bankrupt, who has recovered a portion of the debt owed him by foreclosure of a mortgage on property not owned by the bankrupt, may prove for the full amount of the debt, or only for the balance required to make him whole.

The owners of real estate in Newark, New Jersey, executed to the petitioner a bond in the penal sum of $23,000, conditioned for the payment of $11,500, secured by a mortgage on the land. The mortgagors subsequently conveyed the premises to the Eastern Sash and Door Company, which expressly assumed the mortgage debt. That company afterward conveyed to one Yavne. A default occurred and the petitioner filed a foreclosure bill against Yavne. The amount due was found to be $10,220.96, with interest and costs. The property was sold by the sheriff and bid in by the petitioner for $100. Meanwhile the Sash and Door Company had been adjudicated a bankrupt. The petitioner presented a claim against the estate for $10,739.94, the amount then due on the bond less the $100 bid at the sale. It was stipulated that the mortgaged property acquired in foreclosure was worth $9,000. The referee reduced the claim to the difference,—$1,739.94,—and ruled the petitioner was not entitled to prove for any greater sum. The District Court and the Circuit Court of Appeals have held the referee's ruling was right.[1] The result appearing to be contrary to the weight of authority[2] we granted certiorari.[3]

[1] 73 F. (2d) 609.
[2] Rule 38, § 5 (b).
[3] 294 U. S. —.

Decision must be governed by relevant provisions of the Bankruptcy Act. The definition found in Section 1 (23)[4] is:

"'Secured creditor' shall include a creditor who has security for his debt upon the property of the bankrupt of a nature to be assignable under this Act, or who owns such a debt for which some indorser, surety, or other persons secondarily liable for the bankrupt has such security upon the bankrupt's assets."

Section 57 (e)[5] directs that "Claims of secured creditors . . . shall be allowed for such sums only as to the courts seem to be owing over and above the value of their securities . . ."

Unless the petitioner was a secured creditor as defined by Section 1 (23) it was not bound to have its security or the avails thereof valued and to prove only for the difference between that value and the face amount of the debt. Petitioner does not come within the definition, for at the date of bankruptcy it held no security against the bankrupt company's property, nor security given by any other person who in turn was secured by the bankrupt's assets.[6] Sections 1 (23) and 57 (e) do not, therefore, forbid the proof of a claim for the principal of the bond with interest, though the petitioner may not collect and retain dividends which with the sum realized from the foreclosure will more than make up that amount. The court below was of this opinion, but thought that Section 68 (a)[7] forbade proof of a claim for more than the balance of the debt after application of the avails of the foreclosure. That section directs, "In all cases of mutual debts or mutual credits between the estate of a bankrupt and a creditor the account shall be stated and one debt shall be set off against the other, and the balance only shall be allowed or paid." The theory upon which this section was held to control the right to prove was thus stated:

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[4] U. S. C. Tit. 11, §§ 1 (23).

[5] U. S. C. Tit. 11, § 93 (e).

[6] The point was involved and necessarily decided, though not adverted to, in *Hiscock* v. *Varick Bank*, 206 U. S. 28; see the same case below *sub nom. In re Mertens*, 144 Fed. 818, 820. See also *In re Headley*, 97 Fed. 765; *Swarts* v. *Fourth Natl. Bank*, 117 Fed. 1; *In re Noyes Bros.*, 127 Fed. 286; *In re Sweetser*, 128 Fed. 165; *Gorman* v. *Wright*, 136 Fed. 164; *Board of County Commissioners* v. *Hurley*, 169 Fed. 92; *In re Bailey*, 176 Fed. 990; *In re Keep Shirt Co.*, 200 Fed. 80; *In re Thompson*, 208 Fed. 207; *Young* v. *Gordon*, 219 Fed. 168; *In re Pan-American Match Co.*, 242 Fed. 995; *In re Anderson*, 11 F. (2d) 380; *Hampel* v. *Minkwitz*, 18 F. (2d) 3; *Bankers Trust Co.* v. *Irving Trust Co.*, 73 F. (2d) 296.

[7] U. S. C. Tit. 11, § 108 (a).

"While the obligation of the bankrupt to pay the mortgage still remained, the mortgagee had gotten possession of the security, and, in enforcing this obligation against the bankrupt, the appellant-creditor [petitioner] must reduce its claim by the admitted value of the security less the $100 paid for it. The bankrupt owed the appellant [petitioner] the amount of the mortgage, and the appellant [petitioner] equitably owed the bankrupt the value of the security in his possession."

This novel application of Section 68 (a) is, we think, inadmissible. A creditor holding security who realizes upon it, does not "owe" his debtor the amount realized. The well understood concept of mutual debts does not embrace such a situation as is here disclosed.

Judgment reversed.

A true copy.

Test:

Clerk, Supreme Court, U. S.